3. *Banking Sector Reforms in India*

The Indian economic development takes place in the realistic world from the 1991 liberalization privatization globalization policy. As per LPG policy all restriction on the Indian economy was totally dissolved, and the soundest phase for the Indian banking system adopt over here. This also changed the scenario of the Macroeconomic world. Banking Sector reforms were initiated to upgrade the operating standard health and financial soundness of the banks.

The Government of India setup the **Narsimham Committee** in 1991, to examine all aspects relating to structure, organization and functioning of the Indian banking system the recommendations of the committee aimed at creating competitive and efficient banking system.

Another committee which is **Khan Committee** was instituted by RBI in December, 1997 to examine the harmonization of the role and operations of development financial institutions and banks. It submitted its report in 1998. The major recommendations were a gradual more towards universal banking, exploring the possibility of gain full merger between banks and financial institutions.

Then the **Verma Committee** was established, this committee recommended the need for greater use of IT even in the weak public sector banks, restructuring of weak banks but not merging them with strong banks, VRS for at least 25% of the staff. The Banking Sector reforms aimed at improving the policy frame work, financial health and institutional infrastructure, there are two phases of the banking reforms.

Banking Sector Reform can be Divided into Two Parts

(A) Phase-I Reforms
1. Deregulation of Interest Rates
2. Branch Expansion
3. Permission to Deal in Capital Market
4. Constituting Debt Recovery Tribunals
5. Freedom to Exercise Human Resource Policy
6. Change in the Constitutional Board
7. Introducing of Prudential Norms

(B) Phase-II Reforms
1. Capital Adequacy Norms
2. Assets Quality
3. Regulation and Supervision
4. System and Methods
5. Legal Amendments
6. Restructuring the Banking Industry

(A) Phase-I Reforms

1. **Deregulation of Interest Rates :** These banks have been given the right to decide the rate of which they are lending. No debt PLR (Prime Lending Rate) have been decided by RBI but after that authority have been given to the banks to decide the interest rates on their own self.

2. **Branch Expansion :** Under this reform the bank has been given authority to expand branch as the requirement but the permission of authority.

3. **Permission to Deal in Capital Market :** Till this reform the bank public sector as well as private sector and foreign banks are not allowed to deal in the capital market. But after this reform the banks are allowed to deal in the capital market and trade of equity, preference, debenture and other capital market instruments.
4. **Constituting Debt Recovery Tribunals :** Special debt recovery tribunal has been established under 10 to 11 Zones in India. It is exclusively made for the NPA management. It is the main reform suggestion by the Narshimaham Committee.
5. **Freedom to Exercise Human Resource Policy :** The freedom has been given to banks to clear with the human resource of banks. Now banks can appoint their chief executive officers and other officers as and when they require.
6. **Change in the Constitutional Board :** Under this reform the bank can change as per need in the constitutional board of banks, they can make change in board of directors. Power and duties also assign to the officers.
7. **Introducing of Prudential Norms :** The bank has to follow certain norms that has been as part of reform which includes :
   - To ensure Capital Adequacy
   - Proper Income Recognition
   - Classification of Assets
   - Provision against the Doubtful debts

(B) Phase-II Reforms

1. **Capital Adequacy Norms** : The Basel norm of capital adequacy was introduced in India following the recommendations of the Narsimham Committee -1991.
   - Capital adequacy ratio to be raised from 8% to 10% by 2002.
   - 5% market risk weight of fixed income securities and open foreign exchange position limits.
   - Market discipline of the banks
   - Capital adequacy ratio is calculated on the base of risk weights on assets on the book of banks.
2. **Assets Quality :** The problem that the banks are facing is NPA. The recommendations of Narshimaham Committee-II were :
   - Bank should aim to reduce gross non-performing assets to 3% and Net NPA by 0% at the-2002.
   - The income should be recognized at 90 days was reduced from 180 days.
   - The credit regulation was reduced from 40% to 10%.
3. **Regulation and Supervision :**
   - Board for financial regulation and supervision to be constituted with statutory Powers.
   - Greater emphasis on public disclosure as opposed to disclosure to regulators.
   - Banking regulation and supervision to be progressively linked from monetary policy.

4. **System and Methods :**
   - Banks to start recruitment of skilled and specialized manpower from the market or the better work face
   - Overstaffing will be reducing by the introducing the retirement schemes of VRS
   - Flexibility will be given to the public sector banks employees in remuneration structure.
   - The introduction of computer and technology will be rapid.
5. **Legal Amendments :**
   - Broad range of legal reforms to facilitate recovery of problem loans.
   - Introduction of laws governing electronic fund transfer.
   - Many of the important recommendations of Narsimham Committee II have been accepted and are under implementation the second generation banking reforms concentrate on strengthening the foundation of the banking system by structure technological up graduation and human resource development.
6. **Restructuring the Banking Industry :**
   - Merger are not to be imported by re-regulators they should be market driven.
   - Bank to be given a better function autonomy.
   - Entry of new private sector banks and foreign bank will be continue.

Capital Adequacy and Tire-I and II Capital

This capital adequacy was introduced for Indian commercial banks based on the **Basel committee proposals (1988)** which prescribes the two Tier Capital for banks as follows.

(A) Tier-I Capital : Also known as **core capital** the most permanent and readily available support against unexpected losses includes

- Paid up capital, statutory reserve and share premium
- Capital reserve and other disclosed free reserve
- (Less) : equity investment in subsidiaries, Intangible assets, losses in the current period, forward losses.

(B) Tier-II Capital : It includes

- Undisclosed reserve and fully paid up cumulative perpetual shares
- Revaluation reserve arising out of the revaluation of the assets that are undervalued in the banks books
- General provision and loss reserve not attributable to actual diminution in value or identifiable potential loss in any specific assets and available to meet unexpected losses
- Subordinated debt that is fully paid unsecured subordinated debt that is fully paid up.

Tier-II capital should not be more that tier-I capital 100% and subordinated debt instruments should be limited to 50% of tier-I capital.

Basel Norms

Basel is a city in Switzerland which is also the headquarters of Bureau of International Settlement (BIS).

- BIS fosters co-operation among central banks with a common goal of financial stability and common standards of banking regulations.
- The Bank for International Settlements (BIS) established on 17 May 1930, is the world's oldest international financial organisation. There are two representative offices in the Hong Kong and in Mexico City. In total BIS has 60 member countries from all over the world and covers approx 95% of the world GDP.

Objective :

- The set of the agreement by the BCBS (BASEL COMMITTEE ON BANKING SUPERVISION), which mainly focuses on risks to banks and the financial system are called Basel accord.
- The purpose of the accord is to ensure that financial institutions have enough capital on account to meet the obligations and absorb unexpected losses.
- India has accepted Basel accords for the banking system.
- BASEL ACCORD has given us three BASEL NORMS which are BASEL 1,2 and 3.

Basel-I :

- In 1988, The Basel Committee on Banking Supervision (BCBS) introduced capital measurement system called Basel capital accord, also called as Basel 1.
- It focused almost entirely on credit risk, It defined capital and structure of risk weights for banks.
- The minimum capital requirement was fixed at 8% of risk-weighted assets (RWA).
- India adopted Basel 1 guidelines in 1999.

The twin objectives of Basel I was :

1. To ensure an adequate level of capital in the international banking system.
2. To create a more level playing field on the competitive environment.

Basel-II :

In 2004, Basel II guidelines were published by BCBS, which were considered to be the refined and reformed versions of Basel I accord.

The guidelines were based on three parameters which are as follows :

- Banks should maintain a minimum capital adequacy requirement of 8% risk assets.
- Banks were needed to develop and use better risk management techniques in monitoring and managing all the three types of risks that is credit and increased disclosure requirements.
- The three types of risk are operational risk, market risk, capital risk.
- Banks need to mandatory disclose their risk exposure, etc. to the central bank.
- Basel II norms in India and overseas are yet to be fully implemented.

Basel-III :

- In 2010, Basel III guidelines were released. These guidelines were introduced in response to the financial crisis of 2008.

- In 2008, Lehman Brothers collapsed in September 2008, the need for a fundamental strengthening of the Basel II framework had become apparent.
- Basel III norms aim at making most banking activities such as their trading book activities more capital intensive.
- The guidelines aim to promote a more resilient banking system by focusing on four vital banking parameters viz. capital, leverage, funding and liquidity.
- Presently Indian banking system follows Basel II norms.

Some of prominent features of Basel III, are :

- **Increased Quantity and Quality of Capital :** Under Basel III, Tier I capital is the predominant form of regulatory capital. It is stipulated at a minimum 75% of the total capital.
- **Enhancing Risk Coverage :** The measures have been introduced under Basel III, to strengthen the capital requirements for counterparty credit exposures arising from banks' OTC derivatives, repo and securities financing activities. They also provide incentives to strengthen the risk management of counterparty credit exposures
- **Leverage Ratio :** Pre-crisis, the leverage of some of the internationally active banks was at a high level of about 50 times of the capital, even though such banks complied with capital adequacy requirement. The risk of leverage, particularly when built up with short term borrowings, and the consequential impact of deleveraging during periods of stress by withdrawing credit to the real sector, accentuated the crisis. The Basel Committee has, therefore, introduced a simple, transparent, non-risk based leverage ratio as a supplementary "backstop" measure to the risk based capital requirements.
- **Liquidity Regulations :** Basel has introduced two new liquidity standards to improve the resilience of banks to liquidity shocks. In the short term, banks will be required to maintain a buffer of highly liquid securities measured by the **Liquidity Coverage Ratio (LCR)**. This liquidity buffer is intended to promote resilience to potential liquidity disruptions over a 30-day horizon.

  Another liquidity risk measure, the **Net Stable Funding Ratio (NSFR),** requires a minimum amount of stable sources of funding at a bank related to the liquidity profile of the assets, as well as the potential for contingent liquidity needs arising from off-balance sheet commitments, over a one-year horizon.
- **Capital Conservation Buffer :** Drawing lessons from the crisis that banks were distributing earnings even during periods of stress, Basel III prescribes that a capital conservation buffer of 2.5% of R W As, comprising common equity Tier I capital, over and above the minimum common equity requirement of 4.5% and total capital requirement of 8% (5.5% and 9% respectively for Indian banks), needs to be built up outside periods of stress.
- **Countercyclical Capital Buffer :** The countercyclical capital buffer is aimed at ensuring that banking sector capital requirements take account of the macro-financial environment in which banks operate.

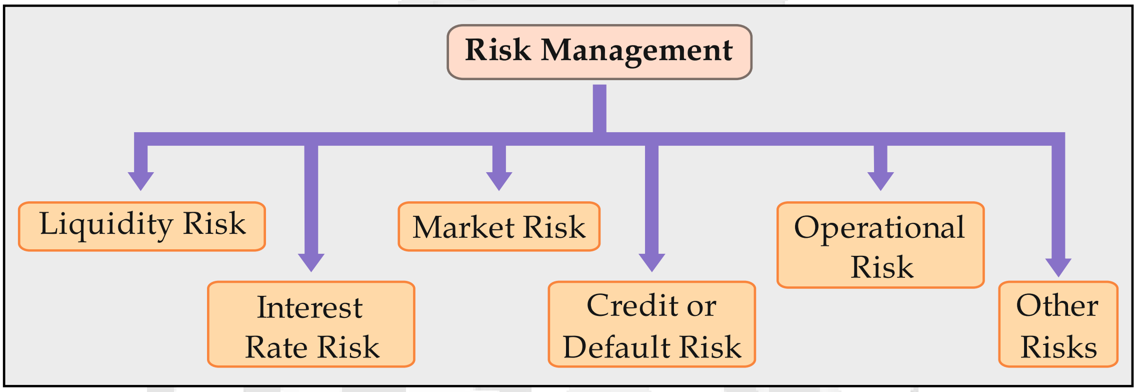
DID YOU KNOW ?

As per RBI guidelines, the Basel Ill capital regulations were to be implemented in phases from April l, 2013, for full implementation by March 31, 2019. In Nov 2018, the RBI extended the timeline by one year to March 31, 2020.

Risk Management

A risk can be defined as an unplanned event with financial consequences resulting in loss or reduced earnings.

Types of Risk : The major risks in the banking business as commonly referred can be broadly classified into :



1. Liquidity

The liquidity risk of banks arises from funding of long-term assets by short-term liabilities, thereby making the liabilities subject to rollover or refinancing risk.

The liquidity risk in banks manifest in different dimensions :

(a) **Funding Risk :** Funding Liquidity Risk is defined as the inability to obtain funds to meet cash flow obligations. For banks, funding liquidity risk is crucial. This arises from the need to manage liquidity risk explicitly.

(b) **Time Risk :** Time risk arises from the need to compensate for non-receipt of expected inflows of funds i.e., performing assets turning into non-performing assets.

(c) **Call Risk :** Call risk arises due to the crystallisation of contingent liabilities. It may also arise when a bank may not be able to undertake profitable business opportunities when it arises.

2. Interest Rate Risk

Interest Rate Risk arises when the **Net Interest Margin or the Market Value of Equity (MVE)** of an institution is affected due to the changes in the interest rates.

IRR can be viewed in two ways - its impact is on the earnings of the bank or its impact on the economic value of the bank's assets, liabilities and Off-Balance Sheet (OBS) positions. Interest rate Risk can take different forms.

3. Market Risk

The risk of adverse deviations of the mark-to-market value of the trading portfolio, due to market movements, during the period required to liquidate the transactions is termed as

Market Risk. This risk results from adverse movements in the level or volatility of the market prices of interest rate instruments, equities, commodities, and currencies. It is also referred to as Price Risk.

The term Market risk applies to (i) that part of IRR which affects the price of interest rate instruments, (ii) Pricing risk all other assets/portfolio that is held in the trading book of the bank and (iii) Foreign Currency Risk.

(a) **Forex Risk :** Forex risk is the risk that a bank may suffer losses as a result of adverse exchange rate movements during a period in which it has an open position either spot or forward, or a combination of the two, in an individual foreign currency.

(b) **Market Liquidity Risk :** Market liquidity risk arises when a bank is unable to conclude a large transaction in a particular instrument near the current market price.

4. Default or Credit Risk

Credit risk is more simply defined as the potential of a bank borrower or counterparty to fail to meet its obligations in accordance with the agreed terms. For most banks, loans are the largest and most obvious source of credit risk. It is the most significant risk, more so in the Indian scenario where the NPA level of the banking system is significantly high.

Now, let's discuss the two variants of credit risk :

(a) **Counterparty Risk :** This is a variant of Credit risk and is related to non-performance of the trading partners due to counterparty's refusal and inability to perform. The counterparty risk is generally viewed as a transient financial risk associated with trading rather than standard credit risk.

(b) **Country Risk :** This is also a type of credit risk where non-performance of a borrower or counterparty arises due to constraints or restrictions imposed by a country. Here, the reason of non-performance is external factors on which the borrower or the counterparty has no control.

5. Operational Risk

Basel Committee for Banking Supervision has defined operational risk as 'the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events'. Managing operational risk has become important for banks due to the following reasons :

- Higher level of automation in rendering banking and financial services
- Increase in global financial inter-linkages
- The scope of operational risk is very wide because of the above mentioned reasons.

Two of the most common operational risks are discussed below :

(a) **Transaction Risk :** Transaction risk is the risk arising from fraud, both internal and external, failed business processes and the inability to maintain business continuity and manage information.

(b) **Compliance Risk :** Compliance risk is the risk of legal or regulatory sanction, financial loss or reputation loss that a bank may suffer as a result of its failure to comply with any or all of the applicable laws, regulations, codes of conduct and standards of good practice. It is also called integrity risk since a bank's reputation is closely linked to its adherence to principles of integrity and fair dealing.

6. Other Risks

Apart from the above mentioned risks, following are the other risks confronted by Banks in course of their business operations :

(a) **Strategic Risk :** Strategic Risk is the risk arising from adverse business decisions, improper implementation of decisions or lack of responsiveness to industry changes.

(b) **Reputation Risk :** Reputation Risk is the risk arising from negative public opinion. This risk may expose the institution to litigation, financial loss or decline in customer base.

(c) **Systematic Risk :** It is a risk inherent to the entire market segment and is not sector specific it is also known as undiversifiable risk.

(d) **Unsystematic Risk :** It is kind of specific risk which comes with the industry you invest into also referred to diversifiable risk.

Role of RBI in Risk Management in Banks

Here, we will discuss the role of RBI in Risk Management and how the tools called CAMELS was used by RBI to evaluate the financial soundness of the Banks. CAMELS is the collective tool of six components namely

- Capital Adequacy
- Asset Quality
- Management
- Earnings Quality
- Liquidity
- Sensitivity to Market risk

The CAMEL was recommended for the financial soundness of a bank in 1988 while the sixth component called sensitivity to market risk (S) was added to CAMEL in 1997.

In India, the focus of the statutory regulation of commercial banks by RBI until the early 1990s was mainly on licensing, administration of minimum capital requirements, pricing of services including administration of interest rates on deposits as well as credit, reserves and liquid asset requirements.

RBI in 1999 recognised the need for an appropriate risk management and issued guidelines to banks regarding assets liability management, management of credit, market and operational risks. The entire supervisory mechanism has been realigned since 1994 under the directions of a newly constituted **Board for Financial Supervision (BFS),** which functions under the aegis of the RBI, to suit the demanding needs of "a strong and stable financial system. "A process of rating of banks on the basis of CAMELS in respect of Indian "banks and CACS (Capital, Asset Quality, Compliance and Systems & "Control) in respect of foreign banks has been put in place from 1999.

NPA Management

Non-Performing Assets (NPA)

The Reserve Bank has issued directives from 31 March 1993 and presented a new concept of Income Recognition". This is done on the recommendations of **Narsimham Committee.**

According to these directives the banks have to classify their credit facilities into two parts:

(1) **Performing Assets (Standard Assets) :** Standard Asset is one which does not disclose any problem and which does not carry more than normal risk attached to the business. Such an asset is Performing Asset (PA) and should not be an NPA.

(2) **A Non-Performing Asset (NPA) :** NPA refers to a classification for loans on the books of financial institutions that are in default or are in arrears on scheduled payments of principal or interest. In other words, NPA means all those assets which don't generate regular income are known as NPA.

According to RBI, terms loans on which interest or installment of principal remain overdue for a period of more than 90 days from the end of a particular quarter is called a Non-performing Asset.

However, in terms of Agriculture / Farm Loans; the NPA is defined as under: For short duration crop agriculture loans such as paddy, Jowar, Bajra etc. if the loan (installment / interest) is not paid for 2 crop seasons, it would be termed as a NPA. For Long Duration Crops, the above would be 1 Crop season from the due date.

Technical definition by RBI on NPA on different cases NPA is a loan or an advance where :

- Interest and/or installment of principal remain overdue for a period of more than 90 days in respect of a term loan.
- The account remains 'out of order' in respect of an Overdraft/Cash Credit (OD/CC).
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.
- The installment of principal or interest thereon remains overdue for two crop seasons for short duration crops.
- The installment of principal or interest thereon remains overdue for one crop season for long duration crops.
- The amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitization transaction undertaken in terms of guidelines on securitization dated February 1, 2006.
- In respect of derivative transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

Types of NPAs

1. **Standard Assets / Performing Assets :** Assets which are generating regular income to the bank without any default or risk. Such assets carry a normal risk and not NPA in the real sense. A general provision of 0.40% of total outstanding should be made.
2. **Sub-Standard Assets :** An asset which is overdue for a period of more than 90 days but less than 12 months. It is necessary to make provision for at least 15% of the total amount of such assets.

3. **Doubtful Assets :** An asset which is overdue for a period of more than 12 months. The bank is expected to suffer great loss in respect of these assets. While making provision for such assets these are divided in two parts.

4. **Doubtful Period** / **Provision secured portion**

Doubtful Period	Provision secured portion
Up to 1 year	25%
One to three years	40%
More than three years	100%

5. **Loss Assets :** Assets which are doubtful and considered as non-recoverable by bank are called loss Assets.

   Banks have detected the loss but, the amount has not been written off completely or partially.

   Full provision (100%) should be made for the amount outstanding.

6. **Provision of loss if advance is guarantee by Export Credit and guarantee Corporation or DICGC.**

   In the case advance given by bank to any of the customer with guarantee given by ECGC or DICGC, RBI has given some guideline in its circular.

   As per guideline of the RBI security of the customer at market price will be deducted from the advance.

Gross NPA and Net NPA

Gross NPA is advance which is considered irrecoverable, for bank has made provisions, and which is still held in banks' books of account. Gross NPA is the amount which is outstanding in the books, regardless of any interest recorded and debited.

Gross NPA = (Balance in Interest Suspense account + DICGC/ECGC claims received and held pending adjustment + Part payment received and kept in suspense account + Total provisions held).

Net NPA is obtained by deducting items like interest due but not recovered, part payment received and kept in suspense account from Gross NPA. Net NPA is Gross NPA less interest debited to borrowed account and not recovered or recognized as income.

Net NPA = Gross NPA - (Balance in Interest Suspense account + DICGC/ECGC claims received and held pending adjustment + Part payment received and kept in suspense account + Total provisions held).

Cause of NPA

- GDP slowdown : Between early 2000's and 2008 Indian economy were in the boom phase. During this period Banks especially, Public sector banks lent extensively to corporate. However, the profits of most of the corporate dwindled due to slowdown in the global economy, the ban in mining projects, and delay in environmental related permits affecting power, iron and steel sector, volatility in prices of raw material and the shortage in availability of. This has affected their ability to pay back loans and is the most important reason behind increase in NPA of public sector banks.

- One of the main reasons of rising NPA is the relaxed lending norms especially for corporate sector's owners and credit rating is not analyzed properly. Also, to face competition banks are hugely selling unsecured loans which attributes to the level of NPAs.
- 5 sectors Textile, aviation, mining, Infrastructure contributes to most of the NPA, since most of the loan given in these sectors are by PSB, They account for most of the NPA.
- Public Sector banks provide around 80% of the credit to industries and it is this part of the credit distribution that forms a great chunk of NPA. When kingfisher was marred in financial crisis, SBI provided it huge amount of loan which is not able to recover from it.
- There is a myth that main reason for rise in NPA in Public sector banks was Priority sector lending, However according to the findings of Standing Committee on Finance NPAs in the corporate sector are far higher than those in the priority or agriculture sector. However, even the PSL sector has contributed substantially to the NPAs. As per the latest estimates by the SBI, education loans constitute 20% of its NPAs.

  The Lack of Bankruptcy code in India and sluggish legal system make it difficult for banks to recover these loans from both corporate and non-corporate.

Other Factors

- Banks did not conduct adequate contingency planning, especially for mitigating project risk. They did not factor eventualities like failure of gas projects to ensure supply of gas or failure of land acquisition process for highways.
- Restructuring of loan facility was extended to companies that were facing larger problems of over-leverage and inadequate profitability. This problem was more in the Public sector banks.

  Companies with dwindling debt repayment capacity were raising more and more debt from the system.

Steps taken by RBI and Government in last few years to curb NPA :

1. Government has launched 'Mission Indradhanush' to make the working of public sector bank more transparent and professional in order to curb the menace of NPA in future.
2. Government has also proposed to introduce Bankruptcy code.
3. RBI introduced number of measures in last few years which include tightening the Corporate Debt Restructuring (CDR) mechanism, setting up a Joint Lenders' Forum, prodding banks to disclose the real picture of bad loans, asking them to increase provisioning for stressed assets, introducing a 5:25 scheme where loans are to be amortized over 25 years with refinancing option after every 5 years, and empowering them to take majority control in defaulting companies under the Strategic Debt Restructuring (SDR) scheme.
4. NPAs story is not new in India and there have been several steps taken by the GOI on legal, financial, policy level reforms. In the year 1991, Narsimham committee recommended many reforms to tackle NPAs. Some of them were implemented.

5. **The Debt Recovery Tribunals (DRTs) 1993 :** To decrease the time required for settling cases. They are governed by the provisions of the Recovery of Debt Due to Banks and Financial Institutions Act, 1993. However, their number is not sufficient therefore they also suffer from time lag and cases are pending for more than 2-3 years in many areas.
6. **Credit Information Bureau 2000 :** A good information system is required to prevent loan falling into bad hands and therefore prevention of NPAs. It helps banks by maintaining and sharing data of individual defaulters and willful defaulters.
7. **Lok Adalats 2001 :** They are helpful in tackling and recovery of small loans however they are limited up to 5 lakh rupees loans only by the RBI guidelines issued in 2001. They are positive in the sense that they avoid more cases into the legal system.
8. **Compromise Settlement-2001 :**
   - It provides a simple mechanism for recovery of NPA for the advances below Rs. 10 Crores.
   - It covers lawsuits with courts and DRTs (Debt Recovery Tribunals) however willful default and fraud cases are excluded.
9. **Sarfaesi Act-2002 :** The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 - The Act permits Banks / Financial Institutions to recover their NPAs without the involvement of the Court, through acquiring and disposing of the secured assets in NPA accounts with an outstanding amount of Rs. 1 lakh and above.

   The banks have to first issue a notice. Then, on the borrower's failure to repay, they can:
   - Take ownership of security and/or
   - Control over the management of the borrowing concern.
   - Appoint a person to manage the concern.
   - Further, this act has been amended last year to make its enforcement faster.
10. **ARC (Asset Reconstruction Companies) :**
    - The RBI gave license to 14 new ARCs recently after the amendment of the SARFAESI Act of 2002.
    - These companies are created to unlock value from stressed loans. Before this law came, lenders could enforce their security interests only through courts, which was a time-consuming process.
11. **Corporate Debt Restructuring-2005 :** It is for reducing the burden of the debts on the company by decreasing the rates paid and increasing the time the company has to pay the obligation back.
12. **5 : 25 Rule-2014 :**
    - Also known as, Flexible Structuring of Long Term Project Loans to Infrastructure and Core Industries.

- It was proposed to maintain the cash flow of such companies since the project timeline is long and they do not get the money back into their books for a long time, therefore, the requirement of loans at every 5-7 years and thus refinancing for long term projects.

13. **Joint Lenders Forum-2014 :** It was created by the inclusion of all PSBs whose loans have become stressed. It is present so as to avoid loan to same individual or company from different banks. It is formulated to prevent the instances where one person takes a loan from one bank to give a loan of the other bank.
14. **Bad Banks-2017 :** Economic survey 16-17, also talks about the formation of a bad bank which will take all the stressed loans and it will tackle it according to flexible rules and mechanism. It will ease the balance sheet of PSBs giving them the space to fund new projects and continue the funding of development projects.

How to curb the menace of Public Sector Banks (PSB) ?

(a) Short Term Measures :

- Review of NPA'S/Restructured advances: We need to assess the viability case by case. Viable accounts need to be given more finance for turnaround and unviable accounts should either be given to Asset Reconstruction Company or Management/ ownership restructuring or permitting banks to take over the units.
- Bankruptcy code should be passed as soon as possible. Bankruptcy code will make it easier for banks to recover loans from unviable enterprises.
- Government should establish Asset Reconstruction Company (ARC) with equity contribution from the government and the Reserve Bank of India (RBI). The established ARC should take the tumor (of non-performing assets or NPAs) out of the banking system. An ARC acquires bad loans from banks and financial institutions, usually at a discount, and works to recover them through a variety of measures, including sale of assets or a turnaround steered by professional management. Relieved of their NPA burden, the banks can focus on their core activity of lending.

(b) Long Term Measures :

- Improving credit risk management: This includes credit appraisal, credit monitoring and efficient system of fixing accountability and analyzing trends in group leverage to which the borrowing firm belongs to:
- Sources/structure of equity capital: Banks need to see that promoter's contribution is funded through equity and not debt.
- Banks should conduct necessary sensitivity analysis and contingency planning while appraising the projects and it should built adequate safeguards against such external factors.
- Strengthen credit monitoring: Develop an early warning mechanism and comprehensive MIS (Management Information System) can play an important role in it. MIS must enable timely detection of problem accounts, flag early signs of delinquencies and facilitate timely information to management on these aspects.

- Enforce accountability: Till now lower ring officials considered accountable even though loaning decisions are taken at higher level. Thus, sanction official should also share the burden of responsibility.
- Restructured accounts should have treated as non performing and technical write offs where Banks remove NPA'S from their balance sheets permanently should be dispensed with.
- Address corporate governance issues in PSB. This include explicit fit and proper criteria for appointment of top executives and instituting system of an open market wide search for Chairman.

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Key Points & Revision Summary

- ***Indian Financial System***
  1. *Financial Services*
  2. *Financial Instruments/Assets*
  3. *Financial Markets*
  4. *Financial Intermediaries*
- ***Types of Banks***
  1. *Scheduled Bank*
     - *(A) Commercial Banks*
       - *(a) Public Sector Banks*
       - *(b) Private Sector Banks*
         - *(i) Small Finance Banks*
         - *(ii) Payments Banks*
       - *(c) Foreign Banks*
       - *(d) Regional Rural Banks*
     - *(B) Co-Operative Banks*
       - *(a) State Co-operative Banks*
       - *(b) District/Central Co-operative Banks*
       - *(c) Other Co-operative banks*
  2. *Non-Scheduled Banks*
- ***Reserve Bank of India :*** *-The Reserve Bank of India (RBI), as India's central bank, was established on 1st April, 1935 under the Reserve Bank of India Act, 1934.*

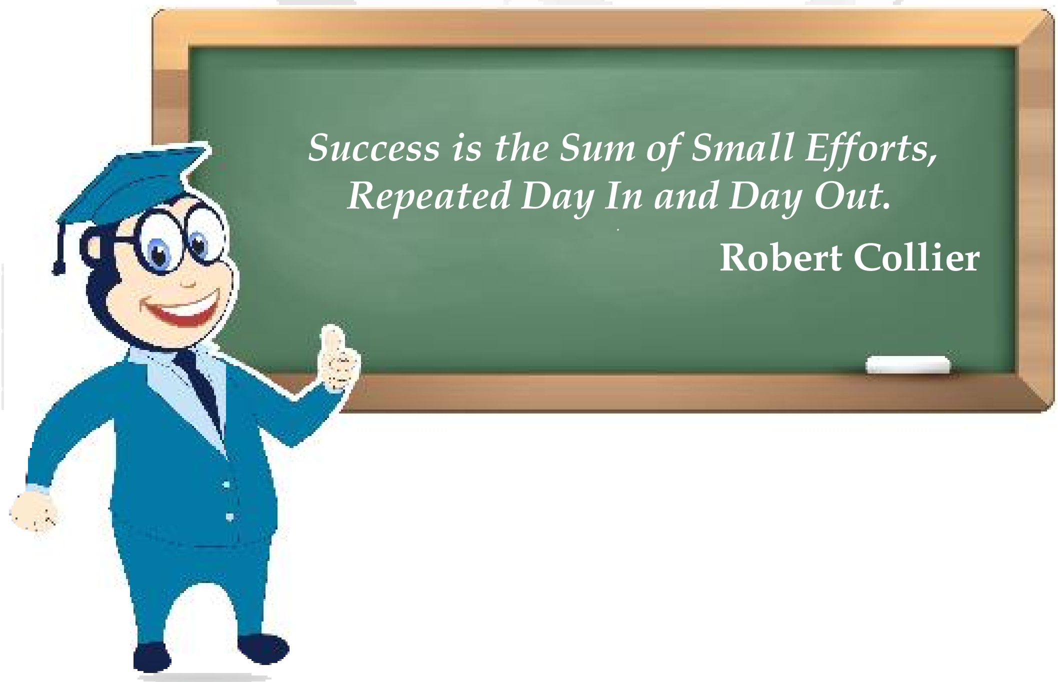
  Functions of RBI :
  1. *Note Issue*
  2. *Banker to the Government*
  3. *Banker's Bank*
  4. *Credit Control*
  5. *Custodian of Foreign Exchange Reserves*
  6. *Developmental Functions*

  Regulatory and Promotional Roles of Reserve Bank of India :
  1. *Regulating the Volume of Currency*
  2. *Regulating Credit*
  3. *Control over Commercial Banks*
  4. *Determining the Monetary and Credit Policy*
  5. *Mobilizing Savings*
  6. *Institutional Credit to Agriculture*
  7. *Specialized Financial Institutions*
  8. *Security to Depositors*
  9. *Advisory Functions*
  10. *Policy Support*
- ***Minimum Reserve System (MRS) :*** *The Reserve Bank of India has to maintain assets of at least 200 crore rupees all the times. Out of this 200 crore, the 115 cr rupee should in the form of Gold or gold bullion and rest 85 cr. should be in the form of foreign currencies.*

Key Points & Revision Summary

- ***Instruments Of Monetary Policy :***
  (A) *Quantitative Techniques*
    1. *Cash Reserve Ratio*
    2. *Statutory Liquidity Ratio*
    3. *Bank Rate Policy*
    4. *Repo Rate or Repurchase Rate*
    5. *Reverse Repo Rate*
    6. *Call Rate*
    7. *MSF-Marginal Standing Facility*
    8. *Open Market Operation (OMO)*

  (B) *Qualitative Techniques*
    1. *Marginal Requirement*
    2. *Moral Suasion*
    3. *Rationing of Credit*
    4. *Direct Action*
- ***Risk Management :*** *A risk can be defined as an unplanned event with financial consequences resulting in loss or reduced earnings.*
- ***NPA Management:***
  Non-Performing Assets (NPA) : *NPA refers to a classification for loans on the books of financial institutions that are in default or are in arrears on scheduled payments of principal or interest.*
  Types of NPAs:
  1. *Standard Assets / Performing Assets*
  2. *Sub-Standard Assets*
  3. *Doubtful Assets*
  4. *Loss Assets*



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